

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 00-0267 ITC
ADJUSTED GROSS INCOME TAX
For Years 1992, 1993, AND 1994**

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ISSUES

I. Adjusted Gross Income Tax – Windfall Profit Tax Refund

Authority: None cited.

Taxpayer protests exclusion of windfall profit tax deduction.

II. Adjusted Gross Income Tax – Net Operating Loss Calculation

Authority: IC § 6-3-2-2.6; IC § 6-3-2-12; *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 505 U.S. 71 (1992)

Taxpayer protests inclusion of foreign dividends in the Department's calculation of net operating losses.

III. Adjusted Gross Income Tax – Net Operating Loss Calculation

Authority: IC § 6-3-2-2.6; IC § 6-3-1-20; IC § 6-3-1-21; IC § 6-3-2-2

Taxpayer protests inclusion of nonbusiness income in the Department's calculation of net operating losses.

IV. Adjusted Gross Income Tax – Computational Errors

Authority: None cited.

Taxpayer protests the assessment of gross income tax on the possible double counting of receipts from taxpayer sales made to partner. Taxpayer also maintains that the net operating loss for 1991 was incorrect.

V. Adjusted Gross Income Tax – Net Operating Loss Carryforward

Authority: None cited.

Taxpayer protests the reduction in Net Operating Loss available for carryforward from 1991.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation with worldwide operations, including locations within the state of Indiana. Taxpayer filed a timely protest of four audit adjustments. Two protests related to the calculation of net operating losses are treated as a single issue for this LOF.

I. Adjusted Gross Income Tax – Windfall Profit Tax Refund

DISCUSSION

For adjusted gross income tax purposes the auditor adjusted the foreign source dividend deduction (line 31 on the 1992 tax return). Included in this amount was a deduction for windfall profit tax refund, which was not attributed to Indiana. Review of the file finds that the auditor inadvertently erred in the computation of the foreign source dividend deduction. As a result, the windfall profit tax refund deduction was disallowed in error. Therefore, the taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

II. Adjusted Gross Income Tax – Net Operating Loss Calculation

Taxpayer protested the Department's calculations of taxpayer's net operating loss, challenging the exclusion of taxpayer's foreign source dividend adjustment in the computation of net operating loss carry forward for years 1992, 1993, and 1994.

The Taxpayer's argument is as follows:

Taxpayer asserts that the Department was incorrect in its foreign source dividend adjustment to the computation of net operating loss available for carryforward for years 1992, 1993, and 1994. *For purposes of computing adjusted gross income (loss for the years at issue)*, the Taxpayer was allowed to deduct 85% of its foreign sourced dividends. However for the purpose of calculating the net operating loss available for carryforward, the auditor's adjustment seeks to add back this allowable deduction –i.e. Taxpayer is allowed to deduct 85% of its foreign sourced dividends for determining [adjusted gross] income, but it must add back this deduction in determining the net operating loss available for carryforward. *(Emphasis added)*

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Taxpayer protest letter of March 24, 1999, pages 2 & 3.

The applicable statute, IC § 6-3-2-2.6 states in relevant part:

(b) ...the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, for the same taxable year during which each loss was incurred.

Department directs the Taxpayer's attention to the language of IC 6-3-2-12(b), which states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is *entitled to a deduction from that adjusted gross income*. The amount of the deduction equals the product of:

the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50%-79%) percent ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e). (*Emphasis added*)

This statutory language is cogent and clear. IC § 6-3-2-12 authorizes pro rata deductions (based on the percentage ownership of the payor by the payee) of certain foreign source dividend income *from* adjusted gross income, not as part *of* the computation of adjusted gross income. There is no similar statutory deduction for the computation of an Indiana net operating loss to be carried forward, which begins with federal adjusted gross income and is modified according to the Indiana statute. Foreign source dividends are part of federal adjusted gross income and are not one of the modifications allowed by IC § 6-3-2-2.6 in arriving at the Indiana net operating loss to be carried forward. Indiana has a specific deduction for foreign source dividends in calculating Indiana adjusted gross income, but there is no statutory provision for adjusting federal taxable income in calculating the Indiana net operating loss to be carried forward. Consequently, taxpayer's protest of the foreign source dividend adjustment is denied.

Taxpayer also cited to the *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 505 U.S. 71 (1992) case as proof the department could not treat foreign and domestic dividends different. Taxpayer fails to demonstrate a disparate treatment between foreign and domestic dividends. The calculation of net operating losses was intended to calculate the net losses, which, as noted above, requires the addition of offsetting amounts-including foreign and domestic dividends.

FINDING

Taxpayer's protest is denied.

III. Adjusted Gross Income Tax – Net Operating Loss Calculation

Taxpayer protests the Department's calculations of taxpayer's net operating loss, challenging the inclusion of taxpayer's non business income in the computation of net operating loss carry forward for years 1992, 1993, and 1994. The Taxpayer's argument, referring to the audit summary worksheet adjustment adding in the income in question, is as follows:

....

The audit workpapers do not provide an explanation for this adjustment. Since the dividends are classified as "business," [as part of the audit adjustment] Taxpayer asserts that there is no statutory or regulatory support for the auditor's adjustment. If the Taxpayer is permitted a business dividend deduction for computing adjusted gross income, such deduction should also be included in the computation of the net operating loss available for carryforward. Taxpayer protest letter of March 24, 1999, pages 2 & 3.

The applicable statute, IC § 6-3-2-2.6 states in relevant part:

(b) ...the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, *for the same taxable year during which each loss was incurred. (Emphasis added)*

The calculation of an Indiana net operating loss to be carried forward begins with federal adjusted gross income and is modified according to the Indiana statute. With the business net operating loss reduction, the auditor calculated the taxpayer's Indiana NOL by adding back income the parent received from various entities, all of which the audit identified as unitary with the parent. The taxpayer's argument implies that the auditor erred in doing so, contending that these items of income were nonbusiness income, did not have Indiana sources, and, therefore, should have been allocated to the parent's commercial domicile outside Indiana instead of being apportioned.

This premise is incorrect. IC § 6-3-1-21 states that "[t]he term 'nonbusiness income' means all income other than business income." *Id.* IC § 6-3-1-20 in turn states that:

[t]he term 'business income means income *arising from transactions and activity in the regular course of the taxpayer's trade or business* and includes income from tangible and intangible property of the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations. *Id. (emphasis added)*

IC § 6-3-2-2.6(a) states that the first step in calculating an Indiana NOL is to determine Indiana AGI as specified in IC § 6-3-2-2. Subsection (a) of the latter section states that “[w]ith regard to corporations and nonresident persons, ‘adjusted gross income derived from sources within Indiana’, for purposes of this article, shall mean and include: ... (5) income from stocks, ... if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.” *Id.* IC § 6-3-2-2.2(g) states that “[r]eceipts in the form of dividends from investments are attributable to this state if the taxpayer’s commercial domicile is in Indiana.” *Id.* The parent’s commercial domicile is in a state other than Indiana, so none of the income the parent received is attributable to Indiana based on the taxpayer’s commercial domicile. However, the auditor reviewed the sources of the income at issue and at the appropriate points within the audit report documented the basis for finding taxpayer had a unitary relationship with the various entities at issue. The taxpayer has failed to provide support for its argument that the relationship between the parent and the various entities was non-unitary. Therefore the Department finds that the income the parent received from these entities was unitary income, and therefore apportionable.

FINDING

Taxpayer’s protest is denied.

IV. Adjusted Gross Income Tax – Computational Error

Taxpayer protests an error in listing amount of addback for a corporation. Sustained subject to audit verification.

FINDING

Taxpayer’s protest is sustained subject to audit verification.

V. Adjusted Gross Income Tax – Net Operating Loss Carryforward

Taxpayer protests an error in the amount of the NOL from 1991 that was available for carryforward. This year was not audited, but the loss carryforward will effect future periods. Audit will review 1991 and will verify that the NOL of 1991 is calculated consistent with the findings in Issue II of this LOF.

FINDING

Taxpayer’s protest is sustained subject to audit verification.